ORIGINAL

MEMORANDUM

30

TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

for

DATE: September 22, 2004

RE: STAFF REPORT FOR UTILITY SOURCE, L.L.C., APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WATER AND WASTEWATER SERVICE TO A PORTION OF COCONINO COUNTY. (DOCKET NO. WS-04235A-04-0073)

Attached is the Staff Report for Utility Source, L.L.C., application for Certificates of Convenience and Necessity in Coconino County. Staff recommends the Commission deny the application.

EGJ:JEF:lhm

Originator: Jim Fisher

Service List for: Utility Source, L.L.C.
Docket No. WS-04235A-04-0073

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

UTILITY SOURCE, L.L.C.

DOCKET NO. WS-04235A-04- 0073

APPLICATION FOR
CERTIFICATES OF CONVENIENCE
AND NECESSITY

SEPTEMBER 2004

STAFF ACKNOWLEDGMENT

The Staff Report for Utility Source, L.L.C. (Docket No. WS-04235A-04-0073) was the responsibility of the Staff members signed below. Jim Fisher was responsible for the review and analysis of the Company's application. John Chelus was responsible for the engineering and technical analysis. James Johnson was responsible for the review and recommendation on rate base and usage rates.

Jim Fisher
Executive Consultant

John Chelus
Utilities Engineer

James Johnson
Public Utilities Analyst

EXECUTIVE SUMMARY
UTILITY SOURCE, L.L.C.
APPLICATION FOR A CC&N
DOCKET NO. WS-04235A-04-0073

On January 30, 2004, Utility Source, L.L.C. ("Utility Source" or "Company") filed an Application for a Certificate of Convenience and Necessity ("CC&N") with the Arizona Corporation Commission ("ACC" or "Commission"). On February 17, 2004, the Commission Utilities Division Staff ("Staff") informed Utility Source that the application was insufficient for administrative purposes.

On March 30, April 6 and July 13, 2004, the Company provided additional information to support the application. On July 20, 2004, Staff informed Utility Source that the application was sufficient for administrative purposes.

Utility Source is an Arizona Limited Liability Company ("L.L.C.") in good standing with the Commission's Corporation Division. Utility Source was requesting a CC&N of approximately 137 acres in which to serve a proposed 650 customers at full build out. The Company was formed to provide service to Flagstaff Meadows, a development west of Flagstaff, near Bellemont, Arizona. Utility Source currently serves approximately 200 customers at Flagstaff Meadows, without a CC&N.

On February 17, 2004 and March 17, 2004, the Arizona Department of Water Resources, ("ADWR") reported that water supplies for the Company were found to be inadequate. On March 22, 2004, Staff informed the Company that as a public service company without a CC&N, and having been found to have an inadequate water supply, Utility Source is required serve the existing customers and to stop connecting additional customers until regulatory issues have been resolved. On June 3, 2004, the Arizona Department of Real Estate informed the developer that the public report for development is invalid and cannot be used for making binding sales.

The Company is subject to a determination by the Arizona Department of Water Resources ("ADWR") of adequate water resources in relation to a determination that the utility will be able to provide water to potential home buyers. In this application, ADWR has issued a finding of inadequate water supply, prior to the Commission authorizing a CC&N.

Water

Staff recommends that the Commission deny the Utility Source, L.L.C. application for a Certificate of Convenience and Necessity to provide water service.

Staff further recommends that the Commission require Utility Source, L.L.C. to provide water service to its existing customers as of March 22, 2004 only, subject to compliance with the following conditions:

1. That the Commission find that the fair value of the property devoted to water service is $2,318,654.

2. That the Commission authorize Utility Source, L.L.C. the water rates and charges shown on Schedule JJ-W-4.

3. That the Commission require Utility Source, L.L.C. to file in Docket Control a tariff consistent with the rates and charges authorized by the Commission within 30 days of the decision in this matter.

4. That the Commission require Utility Source, L.L.C. to file backflow prevention and curtailment tariffs as compliance items in this docket with Docket Control within 45 days of any decision in this matter.

5. That the Commission require Utility Source, L.L.C. to file a rate application no later May 1, 2006, using a 2005 test year.

6. That the Commission require Utility Source, L.L.C. to file a copy of the ADEQ Approval of Construction in Docket Control within 365 days of any decision in this matter.

7. That the Commission require Utility Source, L.L.C. to file a report on the arsenic levels of all production wells in Docket Control within 365 days of any decision in this matter.

8. That the Commission authorize Utility Source, L.L.C. the depreciation rates recommended in this Report.

9. That the Commission require Utility Source, L.L.C. to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Water Utilities.

10. That the Commission require Utility Source, L.L.C. to obtain a County Franchise for the service areas within 365 days of any decision in this matter.

Wastewater

Staff recommends that the Commission approve the application for a Certificate of Convenience and Necessity to provide wastewater services, subject to the following conditions:

1. That the Commission find that the fair value of the property devoted to wastewater service is $1,329,455.

2. That the Commission authorize Utility Source, L.L.C. the wastewater rates and charges shown on Schedule JJ-WW-4.

3. That the Commission require Utility Source, L.L.C. to file a tariff consistent with the rates and charges authorized by the Commission in Docket Control within 30 days of the decision in this matter.

4. That the Commission require Utility Source, L.L.C. to file a rate application no later than May 1, 2006, using a 2005 test year.

5. That the Commission authorize Utility Source, L.L.C. the depreciation rates recommended in this Report.

6. That the Commission require Utility Source, L.L.C. to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Wastewater Utilities.

7. That the Commission require Utility Source, L.L.C. to obtain a County Franchise for the service areas within 365 days of any decision in this matter.

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ATTACHMENTS

Introduction

On January 30, 2004, Utility Source, L.L.C. ("Utility Source" or "Company") filed an Application for a Certificate of Convenience and Necessity ("CC&N") with the Arizona Corporation Commission ("ACC" or "Commission"). On February 17, 2004, the Commission Utilities Division Staff ("Staff") informed Utility Source that the application was insufficient for administrative purposes.

On March 30, April 6 and July 13, 2004, the Company provided additional information to support the application. On July 20, 2004, Staff informed Utility Source that the application was sufficient for administrative purposes.

Background

Utility Source is an Arizona Limited Liability Company ("L.L.C.") in good standing with the Commission's Corporation Division. Mr. Lonnie McCleve is the Company's sole member. Mr. McCleve also operates Greenfield Land Development, the developer requesting service from the Company. Mr. McCleve also is the owner of Fuelco Travel Center, a nearby truck stop with water well, storage tank and wastewater treatment plant.

Utility Source is requesting a CC&N of approximately 137 acres in which to serve a proposed 650 customers at full build out. Utility Source was formed to provide service to Flagstaff Meadows, a development under construction and partial occupancy, located west of Flagstaff, near Bellemont, Arizona. The development is located north of Interstate 40, consists of 675 residential lots, 10 commercial lots and one golf course. Utility Source currently serves approximately 194 customers.

On February 17, 2004 and March 17, 2004, the Arizona Department of Water Resources ("ADWR") reported that water supplies for the Company were found to be inadequate.

On March 22, 2004, Staff informed the Company that as a public service company without a CC&N, and having been found to have an inadequate water supply, Utility Source is required to stop connecting additional customers until regulatory issues have been resolved.

On April 2, 2004, Richard Sallquist, Utility Source's attorney, informed Staff that:

> "The Applicant has been providing wholesale water and wastewater service to the Flagstaff Meadows Homeowners Association, which in turn provides residential water and wastewater service to the Flagstaff Meadows Subdivision. This service has been provided by the respective parties since approximately April 2003."

Staff was further informed that unregulated utility service would continue.

> "We believe the customers are properly and adequately protected and are receiving safe drinking water and sewer service during the transition from the HOA's operations to the requested public service corporation status. Therefore, until such time as the Commission has formalized its economic regulation of the Company, we propose to continue operation of the HOA as originally intended."

On April 9, 2004, Staff informed Utility Source that as issues remain unresolved, Staff would inform the ADEQ and Arizona Department of Real Estate ("ADRE") that the Company is operating without the required CC&N.

On April 20, 2004, Utility Source informed Staff that they had met with ADWR and requested Commission Staff to treat the application "like other CC&N applicants that do not have an ADEQ (sic) determination letter." The Company asserted that such action by Commission Staff would allow the Company to serve existing customers "and adding new customers."

On June 3, 2004, the ADRE informed Mr. McCleve that the public report for development is invalid and cannot be used for making binding sales. ADRE further informed the developer that until the water provider issues are resolved with the ACC, ADWR and ADEQ, the ADRE would not authorize binding sales.

On July 19, 2004, Utility Source provided Staff with documentation describing a water availability study and informed Staff that they expected ADWR to issue a letter of water adequacy within 90 days. Staff issued its sufficiency letter the following day.

On August 19, 2004, ADEQ informed the developer that the approvals for sanitary facilities were suspended and provided the developer with a list of regulatory issues to resolve. In a separate memorandum, ADEQ informed Staff that the initial approvals were based in part on reliance of an existing water system serving the Bellemont Travel Center. That water system is classified as a transient non-community water system. ADEQ found that the water system will need to be reclassified and comply with all state regulations before it can be used for service to the public. Utility Source intends to use Bellemont Travel Center facilities to serve the development.

The August 19, 2004, ADEQ memorandum also informed Staff that the development identified different water providers to ADWR than it did to ADEQ. However, ADWR has consistently found inadequate water availability no matter the listed provider.

On August 20, 2004, the ADRE informed the developer that until water issues are resolved, no new sales can be made. The ADRE allowed continuation with existing sales provided that full disclosure of the lack of compliance with ADEQ and ACC requirements was provided.

On September 7, 2004, Utility Source requested Staff to issue a letter informing regulatory agencies that the Company was required to serve existing customers.

On September 15, 2004, Staff informed Utility Source that an existing customer is defined as requesting service, setting a meter and receiving service prior to March 22, 2004. Staff advised the Company to retain all records to enable verification. Staff also informed the Company that the agreement of customer definition is conditioned on the developers' full disclosure of the ADWR letters of inadequacy and that the rates charged are not authorized by the Commission.

Water System

Utility Source is proposing a water system that will consist of three deep wells (107 gpm total capacity), three shallow wells (44 gpm total capacity), two storage tanks (285,000 [for excess effluent from the wastewater plant] and 422,000 gallons), a booster system, and a distribution system to serve 652 customers within the first five years. Utility Source is currently serving approximately 200 customers.

On April 8, 2004, consulting engineers for the developer provided their final report on estimated water availability. The consulting engineer's report provides that current ground water production is 70 gpm and that the proposed development requires an additional 130 gpm. The final report provides that two additional deep wells were constructed but failed to obtain adequate groundwater yield.

According to the April 8, 2004 report, seven wells have been drilled on the Bellmont property, five of the seven are at depths of 65 to 300 feet. Those wells have obtained yields of 7, 12, 10 and 5 gpm. Two deep wells have been drilled to the Coconino Sandstone at a depth of 2,440 feet and 2,100 feet. The two deep wells produce 14 gpm and 18 gpm, respectively.

The report recommends another well to be drilled into the Bellmont fault at a depth of 2,200 feet.

The estimated project costs for the water system in this application are shown on schedule 8 of the Utility Source schedules. The costs are shown to total $2,677,900 for both backbone plant and on-site facilities. The costs seem to be reasonable and appropriate. However, approval of this CC&N application does not imply any particular future treatment for the rate base. No "used and useful" determination of the proposed plant in service was made, and no conclusions should be inferred for rate making or rate base purposes.

Arizona Department of Water Resources ("ADWR") Compliance

The Company is subject to a determination by the ADWR of adequate water resources in relation to a determination that the utility will be able to provide water to potential home buyers.

According to ADWR, the Adequate Water Supply program, first created in 1973, operates outside of the Active Management Areas as a consumer protection program. Developers are required to obtain a determination from ADWR concerning the quantity and quality of water available before the ADRE will allow any lot sales.

If the application for a Water Adequacy Report successfully demonstrates that water of sufficient quality will be physically, legally, and continuously available for the next 100 years, then ADWR will determine the water supply to be adequate. If the water supply is determined to be inadequate, the developer may still sell lots, but the inadequate determination must be disclosed to potential buyers in the public report approved by ADRE and in all promotional materials. In this application, ADWR issued a finding of inadequate water supply, prior to the Commission authorizing a CC&N.

In July 2004, Utility Source submitted a physical availability demonstration ("PAD") application to ADWR. An evaluation has not yet been completed. The application makes the argument that the regional Coconino Aquifer can support a total annual supply of 346 acre-feet per year for 100 years and that total current and committed demand through Phase III for the 675 lots is 188 acre-feet per year for 100 years.

Utility Source has not demonstrated that the proposed water system will have adequate production capacity to serve the proposed CC&N area. Staff recommends that Utility Source should be required to supply documentation from ADWR stating that Utility Source has a 100 year supply of water available to serve its requested CC&N area before the system can connect any additional customers than are currently authorized under Staff's September 15, 2004 letter.

Arizona Department of Environmental Quality ("ADEQ") Capacity Development

The applicant lists the existing Bellemont Travel Center, Public Water System ("PWS") – 03-300 as its water supply. This is a transient non-community water system which, according to ADEQ, is currently delivering water that meets water quality standards. Arsenic levels in the wells runs around 2 parts per billion ("ppb"), which is below the new standard of 10 ppb.

This system will need to be reclassified from the current transient non-community water system to a community water system by ADEQ in order to serve the requested CC&N area. This system will also have to go through capacity development review.

ADEQ Capacity Development rules, effective September 23, 1999, require new public drinking water systems to meet distinct financial, managerial and technical capacity requirements. ADEQ will accept a financial determination made by this Commission as meeting the financial capacity requirements for new water systems under the jurisdiction of the Commission. The technical and managerial capability is determined by ADEQ.

All three components are combined in the final approval of the water company's "elementary business plan", pursuant to ADEQ Rule R18-4-606. The three components are reviewed and approved sequentially, with the technical capacity approval and "Approval to Construct" being the last performed. The Approval to Construct acts as a control point in the process, and once an Approval to Construct has been issued, it can be assumed that the water company has complied with the capacity development rules.

Based on the above criteria, it is Staff's recommendation that Utility Source be required to submit a copy of the initial ADEQ "Approval To Construct" to the Director of Utilities, Arizona Corporation Commission, within 12 months of the effective date of the final decision and order in this matter.

Special Service Tariffs

A "Curtailment Plan Tariff" is an effective tool to allow a water company to manage its resources during periods of water shortages due to pump breakdowns, droughts, or other unforeseeable events. A "Cross Connection/Backflow Tariff" gives a private water utility the means and authority to implement a cross connection program as required by Arizona Revised Statutes and Administrative Codes. The cross connection tariff provides for the installation and testing of backflow devices and provides for corrective actions where cross connection hazards exist. Since Utility Source does not yet have either a curtailment tariff or cross connection tariff, this CC&N application provides an opportune time to prepare and file such tariffs.

Utility Source submitted a curtailment tariff with its application. The language does not conform to the latest requirements for compliance with Commission guidelines. Staff recommends that the Company file a revised curtailment tariff within 45 days after the effective date of any decision and order pursuant to this application. Staff recommends that the tariffs conform to the sample tariff found posted on the Commission's web site (www.cc.state.az.us/utility) or available upon request from Commission Staff. The tariffs should be docketed as a compliance item under this docket number for the review and certification of the Utilities Division Director.

Arsenic

The U. S. Environmental Protection Agency ("EPA") has reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 micrograms per liter ("µg/l") to 10 µg/l. The date for compliance with the new MCL is January 23, 2006.

Due to the fact that all production wells are not in service, Staff recommends that the Company be required to file a report on the actual arsenic levels of its production wells within 60 days of any decision in this matter.

Off-Site Facilities Hook-up Fee

Utility Source submitted a proposal for a hookup fee in their application to assist in the purchase of backbone plant. A hook-up fee can be an appropriate way to recover a portion of the capital burden imposed by new customers on an existing system in compliance with state regulations. However, Staff believes hook-up fees are inappropriate for new CC&Ns. Therefore, Staff recommends denial of the proposed hook-up fee.

Proposed Water Rates

Utility Source is requesting initial water rates with a monthly minimum of \$6.48 and \$1.70 per 1,000 gallons.

Staff is concerned that the proposed rates understate the water production costs for the existing and future customers of Utility Source. Staff recommends a monthly minimum charge of \$24.37. Staff also recommends a three tiered plan which is designed to encourage conservation and produce revenues to more closely match expected expense levels.

Staff's proposed rates are \$6.47 per 1,000 gallons up to 4,000 gallons, increased to \$9.70 per 1,000 gallons up to 12,000 gallons, and \$11.64 for all usage in excess of 12,000 gallons. The Company is also seeking authorization for separate irrigation rates. (See Schedule JHJ-2, attached.)

Depreciation Rates for the Water System

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in the following table, and it is recommended that Utility Source use the depreciation rates by individual National Association of Regulatory Commissioners ("NARUC") category, as delineated in the attached Exhibit 1.

TYPICAL DEPRECIATION RATES FOR WATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		

320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5 percent to 50 percent. The depreciation rate would be set in accordance with the specific capital items in this account.

Plan 208 Approval

The Federal Water Pollution Control Act as amended by the Water Quality Act of 1987 ("Clean Water Act") is a commitment by the federal government to the elimination of pollution in the nation's waters. Each state is required, under Section 208 of the Clean Water Act, to develop and implement area-wide water quality management plans for pollution control.

In Arizona, six (6) Councils of Government ("COGs") have been designated by the Governor as "Water Quality Management Planning Agencies" under Section 208, of the Clean Water Act. The Northern Arizona Council of Governments ("NACOG") is designated by the Governor and the EPA as the area wide water quality management planning agency for Coconino County.

The guidelines for 208 planning set forth in the Clean Water Act are fairly broad so that the various water quality issues in different areas of the nation can be addressed appropriately. Each 208 Plan must identify the water quality management needs in its planning area and provide a program to develop solutions. The NACOG 208 planning process is an ongoing effort in response to changing water resource issues, regulations, treatment technologies and changing demographics.

On the federal level, the Environmental Protection Agency ("EPA") has the responsibility of overseeing the planning efforts necessary to meet the specific requirements of Section 208. The ADEQ administers both the basin-wide planning and water quality monitoring programs. In addition, ADEQ is responsible for reviewing and enforcing water quality standards for the State. For the NACOG 208 Program, the EPA and ADEQ provides guidance in the terms of policy, procedure and review of documents to assure adherence to the requirements of the Clean Water Act.

ADEQ Permits

A major effort of the 208 Plan is the Point Source Plan. Point Source Planning is primarily directed at compiling the preferred wastewater collection and treatment system for the affected area through the year 2020. Toward that end, the Point Source Plan examines population and wastewater flow projections, wastewater treatment plant siting, treatment methods, effluent disposal, reclaimed water reuse and sludge management.

The objective of a Point Source Plan is to identify the preferred wastewater collection and treatment and effluent reuse or disposal systems for the affected area. The regulatory framework for management of water quality is comprised of permit compliance and monitoring of protected uses. The ADEQ defines, monitors and enforces water quality standards for protected uses of surface waters, aquifers and public water supplies. The ADEQ permit framework for point source management consists of three primary elements consisting of the Arizona Pollutant Discharge Elimination System ("AZPDES") the Aquifer Protection Permit ("APP") and the reclaimed water reuse permit program.

The purpose of the AZPDES permit programs is to regulate the quality of point source discharges into the waters of the nation. Based on specific criteria, discharges to rivers, tributaries to the rivers, dry washes and various lakes and canals within the affected area are subject to the AZPDES permit program provisions.

The ADEQ has established Surface Water Quality Standards ("SWQS") as required to meet the goals of the federal Clean Water Act and to protect the quality of surface waters in the state. The EPA incorporates the SWQS and federal regulation related to surface water quality and effluent discharge quality into the AZPDES permits. Pollutant levels established by the AZPDES permit programs vary among wastewater reclamation facilities depending upon the designated use of reclaimed water. Permits are typically issued for a term of five years.

Aquifer Protection Permit

The APP was established by the Environmental Quality Act of 1986 and implemented by rule in 1989. The purpose of the APP program is to protect the groundwater quality and public health from potential environmental risks posed by the facilities that discharge pollutants to the land surface, underlying soil, or groundwater that have a potential to reach an aquifer.

The APP permitting requirements are determined based on the type of facility or land use, capacity of the facility, and/or the type of discharges that the facility will produce. The most crucial requirements for obtaining an APP are demonstrating that the Best Available Demonstrated Control Technology ("BADCT") will be used to minimize the discharge of pollutants, Aquifer Water Quality Standards will not be violated and that the facility processes the financial and technical capability to comply with the permit conditions.

The Environmental Quality Act requires that all domestic wastewater and disposal facilities requiring an APP use BADCT as part of their wastewater treatment process. The ADEQ adopted BADCT requirements for new sewage treatment facilities. The design review of sewage treatment facilities has been consolidated into the APP application review process. BADCT requirements are defined within the rules which require secondary treatment, removal for new facilities and expansion of existing facilities. The revision of the APP rule took effect January 2001.

The reclaimed water use permit program, established in 1985, allows the reuse of reclaimed water for a variety of applications such as agriculture, urban lakes, golf course irrigation, ponds and industrial uses. Water reclamation plants are required by rules to have a reuse permit for the release of reclaimed water for reuse purposes.

There are two main categories of reclaimed water reuse including direct non-potable reuse and indirect reuse. Direct reuse consists of irrigation and makeup water for urban lakes. Indirect reuse typically involves aquifer recharge and recovery. The indirect reuse of reclaimed water usually involves recharge to an aquifer for storage and future recovery. The reclaimed water is typically allowed to infiltrate through the dry soils above the aquifer allowing additional treatment. Recharge projects using reclaimed water are required to obtain an APP.

Utility Source Wastewater System

Utility Source wastewater treatment is provided by a 37,500 and 100,000 gpd SANTEC activated sludge process with de-nitrification. Treatment includes a flow equalization chamber, aeration basins, anoxic basins, and re-aeration in the secondary clarifier, influent pump stations, head works, and chlorination/dechlorination basins. There are two lift stations and one evaporation lagoon. The wastewater facilities appear to be appropriate and adequate for the needs of the planned development.

The utility has received the final permit from the ADEQ. The Permit Number is P104083.

Proposed Rates

Utility Source is requesting usage sensitive wastewater rates of $12.94 per month and $2.73 per 1,000 gallons of water usage.

Staff is concerned that the proposed rates understate the wastewater treatment costs for the existing and future customers of Utility Source.

Staff is recommending initial residential wastewater rates of $40.64. (See Schedule JHJ-3, attached.)

Finance of Plant

According Utility Source's application, the Company anticipates financing the water facilities with a combination of equity, advances in aid of construction, and contribution in aid of construction.

The Company requests Commission authorization for Hook-up fees to finance portions of the water and wastewater plant with non-refundable contributions. Such a request is contrary to Commission policy for initial rates of new utilities. Staff recommends the Commission deny the Company's request.

In addition, the Company is requesting Commission authority to obtain $575,000 in a revolving credit from the developer and Utility Source owner, Mr. McCleve. The Company also seeks authority to obtain$3,202,554 in long-term financing of the utility plant.

Due to the problematic nature of the utility, its customer base, revenue and expense levels, Staff recommends the Commission deny the financing requests.

County Franchise

Utility Source has not obtained a county franchise for the proposed service area. Staff recommends that before any CC&N is granted for this Company it should be required to provide a copy of a Coconino County franchise for the requested service area.

Wastewater Depreciation Rates

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in the following table. It is recommended that the company use depreciation rates by individual NARUC category, as shown below.

TYPICAL DEPRECIATION RATES FOR WASTEWATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
354	Structures & Improvements	30	3.33
355	Power Generation Equipment	30	3.33
360	Collection Sewers – Force	50	2.0
361	Collection Sewers- Gravity	50	2.0
362	Special Collecting Structures	50	2.0
363	Services to Customers	50	2.0
364	Flow Measuring Devices	10	10.0
365	Flow Measuring Installations	20	5.00
366	Reuse Services	50	2.00
367	Reuse Meters and Meter Installations	30	3.33
370	Receiving Wells	30	3.33
371	Pumping Equipment	10	10.0
374	Reuse Distribution Reservoirs	40	2.50
375	Reuse Transmission and Distribution System	50	2.0
380	Treatment and Disposal Equipment	20	5.0
381	Plant Sewers	20	5.0
382	Outfall Sewer Lines	25	4.0
389	Other Plant & Miscellaneous Equipment	15	6.67
390	Office Furniture & Equipment	15	6.67
390.1	Computers & Software	5	20.0
391	Transportation Equipment	5	20.0
392	Stores Equipment	25	4.0
393	Tools, Shop & Garage Equipment	20	5.0
394	Laboratory Equipment	10	10.0
395	Power Operated Equipment	20	5.0
396	Communication Equipment	10	10.0
397	Miscellaneous Equipment	10	10.0
398	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Wastewater companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5 percent to 50 percent. The depreciation rate would be set in accordance with the specific capital items in this account.

Staff Recommendations

Staff recommends that the Commission deny the Utility Source, L.L.C. application for a Certificate of Convenience and Necessity to provide water service.

Staff further recommends that the Commission require Utility Source, L.L.C. to provide water service, subject to compliance with the following conditions:

Water

1. That the Commission find that the fair value of the property devoted to water service is $2,318,654.

2. That the Commission authorize Utility Source, L.L.C. the water rates and charges shown on Schedule JJ-W-4.

3. That the Commission require Utility Source, L.L.C. to file in Docket Control a tariff consistent with the rates and charges authorized by the Commission within 30 days of the decision in this matter.

4. That the Commission require Utility Source, L.L.C. to file backflow prevention and curtailment tariffs as compliance items in this docket with Docket Control within 45 days of any decision in this matter.

5. That the Commission require Utility Source, L.L.C. to file a rate application no later May 1, 2006, using a 2005 test year.

6. That the Commission require Utility Source, L.L.C. to file a copy of the ADEQ Approval of Construction in Docket Control within 365 days of any decision in this matter.

7. That the Commission require Utility Source, L.L.C. to file a report on the arsenic levels of all production wells in Docket Control within 365 days of any decision in this matter.

8. That the Commission authorize Utility Source, L.L.C. the depreciation rates recommended in this Report.

9. That the Commission require Utility Source, L.L.C. to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Water Utilities.

10. That the Commission require Utility Source, L.L.C. to obtain a County Franchise for the service areas within 365 days of any decision in this matter.

Wastewater

1. That the Commission find that the fair value of the property devoted to wastewater service is $1,329,455.

2. That the Commission authorize Utility Source, L.L.C. the wastewater rates and charges shown on Schedule JJ-WW-4.

3. That the Commission require Utility Source, L.L.C. to file a tariff consistent with the rates and charges authorized by the Commission in Docket Control within 30 days of the decision in this matter.

4. That the Commission require Utility Source, L.L.C. to file a rate application no later than May 1, 2006, using a 2005 test year.

5. That the Commission authorize Utility Source, L.L.C. the depreciation rates recommended in this Report.

6. That the Commission require Utility Source, L.L.C. to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Wastewater Utilities.

7. That the Commission require Utility Source, L.L.C. to obtain a County Franchise for the service areas within 365 days of any decision in this matter.

ATTACHMENT A

MEMORANDUM

DATE: September 10, 2004

TO: James E. Fisher

FROM: John A. Chelus

RE: Utility Source L.L.C
CC&N – Water
Docket No. WS-04235A-04-0073

Introduction

Utility Source L.L.C. "Utility Source/Company" has submitted a Certificate of Convenience and Necessity (CC&N) application to provide water service to the Flagstaff Meadows properties in Coconino County. The Flagstaff Meadows properties include Units I, II, and III and the Town Homes Units I and II. This requested area is approximately 10 miles west of Flagstaff in the community of Bellemont and is .214 square-miles or 137 acres in area.

Utility Source is proposing a water system that will consist of three deep wells (107 gpm total capacity), three shallow wells (44 gpm total capacity), two storage tanks (285,000 (for excess effluent from the wastewater plant) and 422,000 gallons), booster system, and a distribution system to serve 652 customers within the first five years. Utility Source is currently serving 133 customers and 68 are ready to be served.

Arizona Department of Water Resources (ADWR) Water Capacity

Utility Source submitted applications to the Arizona Department of Water Resources (ADWR) for a water adequacy determination. ADWR found these water supplies to be inadequate. In July 2004, Utility Source submitted a physical availability demonstration (PAD) application to ADWR. An evaluation has not yet been completed. The application makes the argument that the regional Coconino Aquifer can support a total annual supply of 346 acre-ft per year for 100 years and that total current and committed demand through Phase III for the 675 lots is 188 acre-ft per year for 100 years.

Staff concludes that Utility Source has not yet demonstrated that the proposed water system will have adequate production capacity to serve the proposed CC&N area. Staff recommends that Utility Source must supply documentation from ADWR stating that Utility Source has a 100 year supply of water available to serve its requested CC&N area.

Cost Analysis

The estimated project costs for the water system in this application shown on schedule 8 of the Utility Source schedules docketed on August 10, 2004 total $2,677,900 for both backbone plant and on-site facilities. The costs seem to be reasonable and appropriate. However, approval of this CC&N application does not imply any particular future treatment for the rate base. No "used and useful" determination of the proposed plant in service was made, and no conclusions should be inferred for rate making or rate base purposes.

Arizona Department of Environmental Quality (ADEQ) Capacity Development

The applicant lists the existing Bellemont Travel Center, Public Water System (PWS) – 03-300 as its water supply. This is a transient non-community water system which according to ADEQ is currently delivering water that meets water quality standards. Arsenic levels in the wells runs around 2 parts per billion "ppb", which is below the new standard of 10 ppb.

This system will need to be reclassified from the current transient non-community water system to a community water system by ADEQ in order to serve the requested CC&N area. This system will also have to go through capacity development review.

ADEQ Capacity Development rules require new public drinking water systems to meet (1) financial capacity, (2) managerial capacity, and (3) technical capacity requirements. ADEQ will accept a financial determination made by this Commission as meeting the financial capacity requirements for new water systems under the jurisdiction of the Commission. The technical and managerial capability is determined by ADEQ.

All three components are combined in the final approval of the water company's "elementary business plan", pursuant to ADEQ rule R-18-4-606. The three components are reviewed and approved sequentially, with the technical capacity approval and the "Approval to Construct" and/or "Approval of Construction" being the last performed. Therefore it is recommended that Utility Source submit copies of the ADEQ "Approval To Construct" and "Approval of Construction" for all drinking water facilities that are necessary to serve the CC&N within one year of the effective date of the final decision and order in this matter.

Depreciation Rates

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Exhibit 1, and it is recommended that Utility Source use the depreciation rates by individual National Association of Regulatory Commissioners (NARUC) category, as delineated in the attached Exhibit 1.

Off –site Facilities Hook-up Fee

A hook-up fee is an appropriate way to recover the capital burden imposed by new customers. Utility Source submitted a proposal for a hookup fee in their application to assist in the purchase of backbone plant. However, to be consistent with prior decisions, Staff recommends denial of the proposed hook-up fee since this is a new CC&N.

Curtailment Plan Tariff

Utility Source submitted a curtailment tariff with its application. The language does not conform to the latest requirements for compliance with Commission guidelines. Staff recommends that the Company file a revised curtailment tariff within 45 days after the effective date of any decision and order pursuant to this application. Staff recommends that the curtailment tariff shall generally conform to the sample tariff found posted on the Commission's web site (www.cc.state.az.us/utility) or available upon request from Commission Staff. The tariff shall be docketed as a compliance item under this docket number for the review and certification of the Utilities Division Director.

Summary

1. Staff concludes that Utility Source has not yet demonstrated that the proposed water system will have adequate production capacity to serve the proposed CC&N area. Staff recommends that Utility Source must supply documentation from ADWR stating that Utility Source has a 100 year supply of water available to serve its requested CC&N area.

2. Staff concludes that the estimated construction costs seem reasonable and appropriate. However, no "used and useful" determination of the proposed plant in service was made, and no particular future treatment should be inferred for rate making or rate base purposes.

3. This system will also have to go through ADEQ capacity development review. Staff requests that copies of the ADEQ "Approval to Construct" and "Approval of Construction" for all drinking water facilities necessary to serve the CC&N area within one year of the effective date of the final decision and order in this matter

4. Staff recommends that this water system be reclassified from the current transient non-community water system to a community water system by ADEQ as part of the capacity development review in order to serve the requested CC&N area.

5. Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Table I, and it is recommended that the company use the depreciation rates by individual NARUC category, as delineated in the attached Exhibit 1.

6. Staff recommends that the Company file a revised curtailment tariff within 45 days after the effective date of any decision and order pursuant to this application. Staff recommends that the curtailment tariff shall generally conform to the sample tariff found posted on the Commission's web site (www.cc.state.az.us/utility) or available upon request from Commission Staff. The tariff shall be docketed as a compliance item under this docket number for the review and certification of the Utilities Division Director.

7. To be consistent with prior decisions, Staff recommends denial of the proposed hook-up fee since this is a new CC&N.

Exhibit 1

TYPICAL DEPRECIATION RATES FOR WATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

ATTACHMENT B

MEMORANDUM

DATE: September 10, 2004

TO: James E. Fisher

FROM: John A. Chelus

RE: Utility Source L.L.C
CC&N – Wastewater
Docket No. WS-04235A-04-0073

Introduction

Utility Source L.L.C. "Utility Source/Company" has submitted a Certificate of Convenience and Necessity (CC&N) application to provide wastewater service to the Flagstaff Meadows properties in Coconino County. The Flagstaff Meadows properties include Units I, II, and III and the Town Homes Units I and II. This requested area is approximately 10 miles west of Flagstaff in the community of Bellemont and is .214 square-miles or 137 acres in area. The development consists of 675 residential lots, 10 commercial lots and one golf course. Utility Source is already serving 133 customers with 61 customers ready to be served.

Capacity

Wastewater treatment is provided by a 37,500 and 100,000 gallon per day (gpd) SANTEC activated sludge process with de-nitrification. Treatment includes a flow equalization chamber, aeration basins, anoxic basins, and re-aeration in the secondary clarifier, influent pump stations, head works, and chlorination/dechlorination basins. There are two lift stations and one evaporation lagoon. The wastewater facilities appear to be appropriate and adequate for the needs of the planned development.

Arizona Department of Environmental Quality (ADEQ)

The construction of the wastewater treatment plant requires a state Aquifer Protection Permit. The utility has received the final permit from the Arizona Department of Environmental Quality. The Permit Number is P104083.

Cost Analysis

Wastewater treatment plants at this high level of environmental sophistication usually cost between 8 and 10 dollars per gallon, excluding effluent disposal costs. The estimated project costs for the wastewater system in this application shown on schedule 9 of the Utility Source schedules docketed on August 10, 2004 total $1,394,604 for both backbone plant and on-site facilities, which implies an economical and cost effective project. However, approval of this CC&N application does not imply any particular future treatment for the rate base. No "used and useful" determination of the proposed plant in service was made, and no conclusions should be inferred for rate making or rate base purposes.

Depreciation Rates

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Exhibit 1, and it is recommended that the company use the depreciation rates by individual National Association of Regulatory Utility Commissioners "NARUC" category, as delineated in Exhibit 1.

Off –site Facilities Hook-up Fee

A hook-up fee is an appropriate way to recover the capital burden imposed by new customers. Utility Source submitted a proposal for a hookup fee in their application to assist in the purchase of backbone plant. However, to be consistent with prior decisions, Staff recommends denial of the proposed hook-up fee since this is a new CC&N.

Summary

1. Staff concludes that the proposed wastewater system has the necessary treatment capacity to serve the customer base for the first five years.

2. Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Exhibit 1, and it is recommended that the company use the depreciation rates by individual NARUC category, as delineated in the attached Exhibit 1.

3. Staff believes that a hook-up fee is an appropriate method to recover capital costs for future off-site infrastructure from new customers. However, to be consistent with prior decisions, Staff recommends denial of the proposed hook-up fee since it is a new CC&N.

Exhibit 1
TYPICAL DEPRECIATION RATES FOR WASTEWATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
354	Structures & Improvements	30	3.33
355	Power Generation Equipment	30	3.33
360	Collection Sewers – Force	50	2.0
361	Collection Sewers- Gravity	50	2.0
362	Special Collecting Structures	50	2.0
363	Services to Customers	50	2.0
364	Flow Measuring Devices	10	10.0
365	Flow Measuring Installations	20	5.00
366	Reuse Services	50	2.00
367	Reuse Meters and Meter Installations	30	3.33
370	Receiving Wells	30	3.33
371	Pumping Equipment	10	10.0
374	Reuse Distribution Reservoirs	40	2.50
375	Reuse Transmission and Distribution System	50	2.0
380	Treatment and Disposal Equipment	20	5.0
381	Plant Sewers	20	5.0
382	Outfall Sewer Lines	25	4.0
389	Other Plant & Miscellaneous Equipment	15	6.67
390	Office Furniture & Equipment	15	6.67
390.1	Computers & Software	5	20.0
391	Transportation Equipment	5	20.0
392	Stores Equipment	25	4.0
393	Tools, Shop & Garage Equipment	20	5.0
394	Laboratory Equipment	10	10.0
395	Power Operated Equipment	20	5.0
396	Communication Equipment	10	10.0
397	Miscellaneous Equipment	10	10.0
398	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Wastewater companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.

2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

MEMORANDUM

TO: Jim Fisher
Executive Consultant
Utilities Division

FROM: J. H. Johnson
Public Utilities Analyst III
Financial and Regulatory Analysis Section, Utilities Division

DATE: September 21 2004

RE: UTILITY SOURCE, L.L.C.
DOCKET NO. W- 04235A-04-0074

Introduction

On January 30, 2004, Utility Source L.L.C. ("Utility" or "Company"), filed an Application with the Arizona Corporation Commission ("Commission") for a Certificate of Convenience and Necessity ("CC&N") to provide water and wastewater service in Coconino County, Arizona.

Utility filed a separate financing application on January 30, 2004 with the Commission to issue promissory notes ("Application"). The financing application requests authorization to borrow $575,000. The application states that the Company's principal, Lonnie McCleve, will loan those funds to the Company.

On August 2, 2004, Utility filed a motion to consolidate the CC&N and Application dockets based on the fact that the Financing and CC&N applications rely on the same law, facts, and witnesses.

A Procedural Order was issued on August 23, 2004, consolidating the above matters for the purposes of hearing and ordered Staff to file its Staff Report for the consolidated applications on or before September 22, 2004, and scheduled a hearing in these matters for October 12, 2004.

Utility proposes operation of water and wastewater services in Bellemont, Coconino County, Arizona. Bellemont is approximately 10 miles west of Flagstaff, Arizona in an area with historical water shortages. Utility plans on developing water resources to serve a travel center, a motel and residential customers. Utility anticipates 289 residential customers by the end of 2005 and 726 residential customers by the end of year 2009.

The Company states that it has pending with the Arizona Department of Water Resources ("ADWR"), an Application for Physical Availability Determination supporting the 100-year water supply for the entire certificate area. The Company proposes that until such time as a determination is made as to the adequacy of water for the entire project, it will limit service to its existing customers as of March 22, 2004.

Water CC&N

FVRB

Consistent with Commission rules, the Company's filing included the required five-year projections for plant values, operating revenues, operating expenses, and number of customers. Projections and assumptions are necessary to establish a fair value rate of return and initial rates due to the lack of historical information. Staff reviewed the Company's projections and found them to be unreasonable as Company revenues in the fifth year are projected to be insufficient to cover operating expenses and provide a rate of return on Original Cost Less Depreciation ("OCLD"). Rate Base for the Water Division is calculated to be $2,768,846 for the Year Ending 2009 (Schedule JHJ-1).

Plant in Service

The Company plans to initially invest $210,000 for Land and $2,467,900 in backbone plant and on-site facilities for a total Year One investment of $2,677,900. The Company plans additional investments of: Year Two - $655,500, Year Three - $175,000, Year Four - $175,000 and $650,000 in Year Five for a projected Plant in Service total $4,333,400 by the end of Year Five.

Revenues/Expenses

Staff has utilized Schedule 1, Page 2 of 4 which was provided in response to Data Request JHJ 1.3. This document shows projected revenues for 2005 and four subsequent years. Staff's analysis, while taking into account all of the years presented, is concentrated on 2009, the fifth year of operation when breakeven or profitability is usually expected.

Staff's pro forma water income statement, Schedule JHJ 4A, reflects water revenues of $507,370 (including provision for income tax) for year 2009 and operating expenses of $258,174. Staff made no adjustments to expenses. Staff's pro forma revenue requirements projects Operating Income of $249,196, an approximately nine percent rate of return on the projected Rate Base of $2,768,846.

Rate Design

The Company's projected revenue is derived from the residential and commercial customer classes. Staff has reviewed the estimates and found them unreasonable in that continuing losses are projected through year five.

There are substantial differences between the Company's proposed rates and Staff's recommended rates. Staff has provided minimum charges on all meter sizes in case future construction requires the use of larger meters. Staff's recommended rates will result in a monthly residential bill of $57.43 based on average usage of 4,740 gallons per month. The Company's proposed rates would result in a monthly residential bill of $19.90 (Schedule JHJ-2).

Wastewater CC&N

FVRB

Consistent with Commission rules, the Company's filing included the required five-year projections for plant values, operating revenues, operating expenses, and number of customers. Projections and assumptions are necessary to establish a fair value rate of return and initial rates due to the lack of historical information. Staff reviewed the Company's projections and found them to be unreasonable as Company revenues in the fifth year are projected to be insufficient to cover operating expenses and provide a rate of return on OCLD. Rate Base for the Wastewater Division is calculated to be $1,499,224 for the Year Ending 2009 (Schedule JHJ-1).

Plant in Service

The Company plans to initially invest $105,000 for Land and $1,469,579 in backbone plant and on-site facilities for a total Year One investment of $1,574,579. The Company plans additional investments of: Year Two - $164,400, Year Three - $120,000, Year Four - $150,000 and $600,000 in Year Five for a projected Plant in Service total $2,608,979 by the end of Year Five.

Revenues/Expenses

Staff has utilized Schedule 1, Page 4 of 4 which was provided in response to Data Request JHJ 1.3. This document shows projected revenues for 2005 and four subsequent years. Staff's analysis, while taking into account all of the years presented, is concentrated on 2009, the fifth year of operation when breakeven or profitability is usually expected.

Staff's pro forma wastewater income statement reflects water revenues of $339,319 for year 2009 and operating expenses of $204,472. Staff made no adjustments to expenses. Staff's pro forma revenue requirements projects Operating Income of $134,847, an approximately nine percent rate of return on the projected Rate Base of $1,499,224.

The typical bill for the 676 residential customers projected for year 2009 is $40.64. There are two commercial customers whose typical bill is projected at provide $9,642 of the revenues for the projected year 2009.

Rate Design

The Company's projected revenue is derived from the residential and commercial customer classes. Staff has reviewed the estimates and found them unreasonable in that continuing losses are projected through year five. There are substantial differences between the Company's proposed monthly charge and the charge recommended by Staff. Staff's recommendations will result in a monthly residential charge of $40.64 while the Company proposes a monthly residential charge of $12.94 (Schedule JHJ-3).

The Company's hookup fees were removed by Staff. It is this Commission's normal procedure to allow hook-up fees only to companies already holding and operating under an established CC&N.

Finance

Purpose of Financing

Staff's review of the application filed on January 30, 2004, indicates that Utility is requesting authorization for a revolving line of credit in the amount of $575,000 with expenditures for plant totaling $4,854,479 in 2005. The application states on page 2, line 1-2 that the funds necessary to properly operate the Company total $575,000 and will be used for plant additions, maintenance, and operating expenses.

The Company also states it is to borrow $3,202,554 as part of the project but does not identify the source or ask for Commission financing authorization for that amount.

Notice

Utility stated on page 2, line 7 of its Application to issue Promissory Notes, that it would provide notice of the filing of the application in conformity with A.R.S. 40-302. Utility has not met its filing requirements to provide an affidavit of publication and notice published in newspaper(s) of general circulation in the area in which Utility seeks to provide water and wastewater services.

Description

The loan as described in the application is to be a $575,000 revolving line of credit priced at prime plus two percent per annum (computed on a 365 day year) with quarterly interest payments and a final maturity date of December 31, 2014. Prime rate is currently 4.5 percent per annum so the actual interest charge would be 6.5 percent per annum if funded today.

Principal repayment can be made at any time but no specific repayment schedule is contemplated.

Staff has not calculated the times interest earned ratio ("TIER") and debt service coverage ratios ("DSC") as earnings projections are negative and Staff is not recommending authorization of any loans. TIER would be slightly above 1.0 using the Company projections and DSC would be less than 1.0 with a 10 year amortization on the proposed $575,000 loan indicating a lack of sufficient cash flows.

TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term.

DSC represents the number of times internally generated cash will cover required principal and interest payment on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Staff concludes that financing for a fledgling company is inappropriate as cash flows for repayment are not established.

Financial Analysis

Utility is a fledgling utility with anticipated losses in the initial years. Future financial performance is unknown, therefore debt is inappropriate.

Financial Recommendations

Staff recommends rejecting the financing application. Staff recommends authorization of equity issuance of $6,100,000 for all plant expenditures.

Rate Base/Plant in Service

Staff determined the rate base for the water plant in service to be $2,768,846. Staff determined the rate base for the wastewater plant in service to be $1,499,224. Staff reviewed the Company's projections and found them generally reasonable. The water and wastewater plant in service were found to be reasonable (Schedule JHJ-1).

Revenue and Expenses

As justification for the initial rates, the Company has estimated its revenue and expenses. Staff has reviewed the revenue estimates and they appear unreasonable. Staff did not make any adjustments to expenses. Staff did not remove income tax as the amount presented by the Company approximates the Arizona income tax filing fee even if no tax is owed.

Staff Conclusions and Recommendations

Staff concludes:

That the Company's projected operating income and expenses are unreasonable, and Staff's proposed charges for water and wastewater should be adopted.

That any loan funds expended for operating or maintenance expenses are an inappropriate use of the funds.

Construction of plant assets with financing which is not due in full for 10 years violates the maturity matching principle of loans being repaid over a period similar to the expected life of the assets purchased. Maturity matching improves the balance of cash inflows with cash disbursements.

That future ratepayer's would be paying expenses related to current operations if the revolving line of credit structure was utilized for loans.

Financing authorization for Utility is inappropriate as cash flows are not developed as a source of repayment and are not expected to be for five years.

Company funding is more appropriately the function of equity infusion.

The proposed debt financing is not consistent with sound financial practices because maturity matching is not observed.

Staff recommends denial of the request for financing authorization.

Staff recommends approval of rates and charges for the Company as shown on Schedules JHJ-2 and JHJ-3. In addition to collection of its regular rates, the Company may collect from its customers a propionate share of any privilege, sales, or use tax.

Staff recommends that the Company be required to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Water and Wastewater Utilities.

Schedule JHJ-1

UTILITY SOURCE PLANT ASSETS/RATE BASE

Water

3.41% Deprec.	Year 1	Year 2	Year 3	Year 4	Year 5
Land	$ 210,000	$ 210,000	$ 210,000	$ 210,000	$ 210,000
Plant	2,467,900	3,123,400	3,298,400	3,473,400	4,123,400
Acc.Deprec	91,296	186,628	296,119	411,579	541,104
Net Plant	$ 2,586,604	$ 3,146,772	$ 3,212,281	$3,271,821	$ 3,792,296
Beginning	$ -	$ 2,467,900	$ 3,123,400	$3,298,400	$ 3,473,400
Added	2,467,900	655,500	175,000	175,000	650,000
Ending	$ 2,467,900	$ 3,123,400	$ 3,298,400	$3,473,400	$ 4,123,400
Accumulated Depreciation					
Beginning		$ 91,296	$ 186,628	$ 296,119	$ 411,579
1/2 Yr conv		11,176	2,984	2,984	11,083
Full yr begin bal		84,155	106,508	112,475	118,443
Ending Bal	$ 91,296	$ 186,628	$ 296,119	$ 411,579	$ 541,104
Net Advances	267,950	473,450	648,450	823,450	1,023,450
RATE BASE	2,318,654	2,673,322	2,563,831	2,448,371	2,768,846

Wastewater

3.85% Deprec.	Year 1	Year 2	Year 3	Year 4	Year 5
Land	$ 105,000	$ 105,000	$ 105,000	$ 105,000	$ 105,000
Plant	1,469,579	1,633,979	1,753,979	1,903,979	2,503,979
Acc.Deprec	65,149	124,892	190,111	260,526	345,380
Net Plant	$ 1,509,430	$ 1,614,087	$ 1,668,868	$1,748,453	$ 2,263,599
Beginning	$ -	$ 1,469,579	$ 1,633,979	$1,753,979	$ 1,903,979
Added	1,469,579	164,400	120,000	150,000	600,000
Ending	$ 1,469,579	$ 1,633,979	$ 1,753,979	$1,903,979	$ 2,503,979
Depreciation					
Beginning		$ 65,149	$ 124,892	$ 190,111	$ 260,526
1/2 yr conv		3,165	2,310	2,888	11,550
Full yr begin bal		56,579	62,908	67,528	73,303
Ending bal	$ 65,149	$ 124,892	$ 190,111	$ 260,526	$ 345,380
Net Advances	179,975	344,375	464,375	614,375	764,375
RATE BASE	$ 1,329,455	$ 1,269,712	$ 1,204,493	$1,134,078	$ 1,499,224

Utility Source, L.L.C.
Docket Number WS- 04235A-04-0074
New CC&N

Schedule JHJ 2

RATE SCHEDULE - WATER

	-Proposed Rates-	
Monthly Minimum Charge	Company	Staff
5/8" x 3/4" Meter	N/A	$ 24.37
3/4" Meter	6.48	24.37
1" Meter	8.02	61.47
1½" Meter	9.62	121.87
2" Meter	14.00	194.99
3" Meter	n/a	365.61
4" Meter	58.00	609.35
6" Meter	89.80	1,218.70
All classes except irrigation		
Commodity Charge per 1,000 Gallons		
From 1 up to 6,000 gallons	$1.70	n/a
From 6,001 up to 15,000 gallons	1.70	n/a
In excess of 15,000 gallons	1.70	n/a
From 1 up to 4,000 gallons		$ 6.47
From 4001 up to 12,000 gallons		9.70
All gallons over 12,000 gallons		11.64
Irrigation Meters		
Charge per I000 gallons for usage	n/a	$ 11.64
Standpipe or bulk water per		
1,000 gallons	6.00	11.64
Constructiopn Water	6.00	11.64
Hook-up fees		
Water:		
Meter Size		
5/8 x 3/4	n/a	0.00
3/4"	1,000	0.00
1	1,666	0.00
1 1/2"	3,333	0.00
2	5,330	0.00
3	n/a	0.00
4	16,660	0.00
6	33,320	0.00
Establishment of Service per Rule R14-2-403.D	$20.00	$20.00
Establishment of Service ater hours		
per rule R14-2-403.D.2	40.00	40.00
Re-establishment of Service per Rule 14-2-403.D		30.00
Reconnection of service per Rule R14-2-403.D.1	50.00	50.00
Charge for moving meter at customer request per		
Rule R14-2-405.B.5		
After hours service charge, per hour, R14-2-403.D	40.00	40.00
Minimum Deposit per Rule R14-2-403.B		
Meter Reread per Rule R14-2-408	10.00	10.00
Charge for NSF check per Rule R14-2-409.F.1	20.00	$ 20.00
Late payment charge for delinquent bills	1.50%	1.50%
as defined in Rule R14-2-409.C.1	per rule	per rule
Deferred Payment Finance Charge R14-2-409.G	1.50%	1.50%
Deposit Interest, per annum	3%	6%
Service Line and Meter Installation Charges		
5/8" x 3/4" Meter	$0.00	$ 520.00
3/4" Meter	575.00	575.00
1" Meter	660.00	660.00
1½" Meter	900.00	900.00
2" Meter Turbo	1,525.00	1,525.00
2" Meter Compound	0.00	2,320.00
3" Meter Turbo	0.00	2,275.00
3" Meter Compound	0.00	3,110.00
4" Meter Turbo	3,360.00	3,360.00
4" Meter Compound	0.00	4,475.00
6" Meter Turbo	6,035.00	6,035.00
6" Meter Compound	0.00	8,050.00

Main Extension and additional facilities agreements
per Rule R14-2-406.B

Service Charges
All Revenue related taxes will be charged customers.

* Per Commission Rules (R14-2-403.B)

** Months off system times the minimum (R14-2-403.D)

Utility Source L. L. C.
Docket No. WS-04235A-04-0074
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Schedule JHJ-3

RATE SCHEDULE - WASTEWATER

	-Proposed Rates-	
Based on Water Usage Monthly Minimum Charge	Company	Staff
Residential - all sizes	$ 12.94	$ 40.64
Commercial - all sizes		401.75
Commercial - rate per 1,000 water usage		
Car washes, Laundromats, Commercial, manufacturing	$ 2.67	n/a
Hotels, Motels	3.58	n/a
Restaurants	4.42	n/a
Industrial Laundries	3.92	n/a
Waste Haulers	80.00	n/a
Restaurant Grease	70.00	n/a
Treatment Plant Sludge	80.00	n/a
Mud Sump Waste	250.00	n/a
Treated Effluent per Acre Foot		
Hook-up Fee		n/a

All Builders/Developers are required to pay a hook-up fee of $2,000.00 per lot, for connection to the system based on a water connection of 5/8x3/4 or 3/4 inch water meter. Payments are listed for each Water Meter Size below:

	Company	Staff
Service Lateral Size		
4 inch	$ 1,800.00	n/a
6 inch	3,500.00	n/a
Service Line Connection Charge		
Establishment of Service	$ 20.00	$ 20.00
Establishment of Service, *after hours*	40.00	40.00
(Collected only if customers is sewer only)		
Re-establishment of Service*	per rule	per rule
Reconnection of service**	50.00	per rule
After hours service charge, per hour	40.00	40.00
Minimum Deposit***	per rule	per rule
Charge for NSF Check	20.00	20.00
Late payment charge for delinquent bills****	per rule	per rule
Deposit Interest	3.00%	6.00%
Deferred Payment Finance Charge	1.50%	1.50%
Main Extension and additional facilities agreements.*****	Cost	Cost
Service Lateral Connection Charge - Residential	500.00	500.00
Service Lateral Connection Charge - Commercial	Cost	Cost

All revenue related taxes will be charged customers.

RULES AND REGULATIONS
The Company has adopted the Rules and Regulations established by the Commission as a basis for its operating procedures. Ariaona Corporation Commission Rules will be controlling of Company procedures unless specific Commission Orders provide otherwise.

*R14-2-603D
**R14-2-603D
***R14-2-603B
****R14-2-608F
*****R14-2-606B

Utility Source L. L. C. Schedule JHJ-4A
Docket No. WS-04235A-04-0074
New C C & N Application

Projected Statement of Income and Expenses
WATER, FIFTH YEAR

REVENUE	Company	Adjustments	Staff
Water	$ 175,821	$ 331,549	$ 507,370
		-	
EXPENSE		-	
Pumping	16,676	-	16,676
Repairs, Maintenance.	40,680	-	40,680
Insurance	3,000	-	3,000
Treatment/Testing	-	-	-
Management Costs	56,952	-	56,952
Depreciation	133,418	-	133,418
Office Supplies	-	-	-
Income Tax	32	-	32
Property Tax	7,416	-	7,416
TOTAL	$ 258,174	$ 331,549	$ 258,174
Income/Loss	$ (82,353)	$ 331,549	$ 249,196

Utility Source L. L. C.
Docket No. WS-04235A-04-0074
New C C & N Application

Schedule JHJ-4B

Projected Statement of Income and Expenses

WASTEWATER, FIFTH YEAR

REVENUE	Company	Adjustments	Staff
Wastewater	$ 114,612	$ 224,707	$ 339,319
EXPENSE			
Power Cost	2,000	-	2,000
Repairs, Maintenance.	40,680	-	40,680
Insurance	3,500	-	3,500
Treatment/Testing	-	-	-
Management Costs	56,952	-	56,952
Depreciation	96,486	-	96,486
Office Supplies	-	-	-
Legal & Accounting	-	-	-
Income Tax	18	-	18
Property Tax	4,836	-	4,836
TOTAL	$ 204,472	$ 224,707	$ 204,472
Income/Loss	$ (89,860)	$ 224,707	$ 134,847